

CALIFORNIA STATE TEACHERS' RETIREMENT SYSTEM

BILL ANALYSIS

Senate Bill 1983

Senator Soto (As amended 08/23/02)

Position:

Sponsor

Proponents:

ACSA, CRTA, CTA, Delta Kappa Gamma Society

Opponents:

None known

SUMMARY

Senate Bill 1983 makes the following minor changes to the benefit and investment programs administered by the California State Teachers' Retirement System (CalSTRS):

- Allows a member of the Defined Benefit (DB) Program receiving an allowance under Options 6 or 7 to name a new beneficiary after a member's beneficiary dies;
- Changes the basis for calculating the post retirement compensation limitation from the All Urban California Consumer Price Index (CCPI) to the average earnable salary of active members;
- Allows CalSTRS to acquire and develop surplus land owned by school districts through joint ventures and limited partnerships for sale to third parties and leaseback to school districts.

This bill also appropriates \$1,800,000 from the Teachers' Retirement Fund (Fund) to the Teachers' Retirement Board (Board) to maintain and enhance the level of customer service provided by CalSTRS to its members.

HISTORY

AB 430 (Cannella—1996) would have allowed any member who retired prior to 1/1/91 under Option 2 or 3, and whose beneficiary died prior to 1/1/95 and no new option beneficiary had been named by the retired member, to return to the unmodified allowance.

SB 1658 (Costa—1996) would have required the Board to conduct a sample survey to determine the number of members and cost for those who retired before 1/1/91 with an Option 2 or 3, to return to the unmodified allowance, if the option beneficiary died prior to 1/1/95. The Board agreed to conduct the survey without legislation.

SUMMARY OF CHANGES

- The August 23, 2002 amendments deleted provisions that authorized the use of up to .2 years of unused sick leave and the period of disability for selected members who received a Disability Allowance under Coverage A and returned to perform creditable service in the calculation used to determine eligibility for career-based enhancements to DB Program allowances, such as single year final year compensation, the career factor, and the longevity bonus.

CURRENT PRACTICE

Electing An Option Under the Defined Benefit Program

Under existing law, a member who retires may receive an unmodified allowance, equal to a percentage, based on the age of retirement, of final compensation, multiplied by the number of years of service credit, plus a longevity bonus, if eligible. That allowance ceases to be paid when the member dies. A member may elect to modify the allowance by electing one of six different options that continue to pay an allowance to a named beneficiary after the member dies. A member may also elect to name more than one option beneficiary and select from among the six options for each beneficiary. In order to provide an improved survivor benefit if the member dies before retirement, the member may elect an option at the time that he or she becomes eligible to retire.

Currently, under Options 2 and 3, the beneficiary receives 100 percent and 50 percent, respectively, of the member's allowance at the time of the member's death. Options 4 and 5 pay a reduced benefit to the survivor when either the member or the beneficiary dies. If the beneficiary dies before the member, the member may select a new option and/or beneficiary. Option 6 and 7 pay the same percentage of the allowance as paid under 4 and 5, but if the beneficiary dies first, the member's allowance increases, or "pops-up" to the unmodified level, and no new beneficiary can be named.

Postretirement Earnings Limitation

Current law restricts the compensation a retired member can be paid while performing creditable service, without affecting the member's service retirement allowance. The current limit is \$23,540 and that limit is adjusted each July 1 to reflect increases in the CCPI. If the creditable earnings exceed the limit in any plan or school year, the member's retirement allowance is reduced, dollar-for-dollar, by the amount earned in excess of the limit. Beginning July 1, 2002, almost all compensation paid by an employer to a CalSTRS member, such as summer school, is creditable and therefore, counts against the earnings limitation.

Restrictions on CalSTRS Investments

Existing law requires that CalSTRS assets be held for the exclusive purposes of providing benefits to CalSTRS members. As a public pension fund, CalSTRS is not subject to the federal Employee Retirement Income Security Act (ERISA) that governs corporate pension plans. However, CalSTRS' investment decision-making criteria are based on the "prudent expert"

standard, upon which ERISA is based. Teachers' Retirement Law (TRL) imposes additional limitations on investment transactions that directly or indirectly involve a CalSTRS member or employer. Specifically, CalSTRS may not engage in a transaction involving the sale, exchange or leasing of property, lending of money, furnishing of goods or services, or transfer to a CalSTRS member if the financial consideration is less than adequate to CalSTRS.

The TRL also prohibits any acquisition of any security, real property, or loan by any CalSTRS employer, even if, from CalSTRS' perspective, adequate financial consideration is given for the transaction. The California Public Employees' Retirement System (CalPERS) has no similar statutory restriction on investment activity benefiting an employer, nor are such investments entirely prohibited under ERISA. This prohibition on investments concerning employers excludes a universe of potentially prudent investment opportunities in school districts and community college districts that could add value to the portfolio and the membership.

DISCUSSION

Modify Options 6 and 7 To Permit Members Who “Pop-Up” to Name a New Beneficiary and Report to the Legislature on the Efficacy of the Options

This bill modifies Options 6 and 7 to permit members who “pop-up” to the unmodified allowance to name a new beneficiary. Currently, a member may not name a new option beneficiary under Options 6 and 7 after the beneficiary dies. The change in this policy is consistent with choices available to members under Options 2, 3, 4 and 5 that allow a member to choose a new option beneficiary after the death of the original beneficiary.

SB 1983 also requires the Board to evaluate the existing Plan options and annuity options and adopt as a plan amendment, any appropriate changes to the options and annuity options offered to members. Any changes the Board adopts to the options and annuity options could have no net actuarial impact on the Fund, and the Board may establish eligibility criteria necessary to prevent an adverse actuarial impact to the Fund. The bill also provides that any member or participant who retired or filed a pre-retirement election of options prior to the effective date of the plan amendment, could elect to change to an option or annuity option as modified by the Board, if the change would have no adverse effect on the Fund. The member can designate the change during the six-month period that begins with the effective date of the Plan amendment. The bill also requires the member to retain the same option beneficiary as named in the prior designation.

There are six options available to members (as well as the unmodified allowance), each of which has different effects on the allowance of the member and his or her beneficiary or beneficiaries. CalSTRS has found that the number of options offered confuses members and makes it difficult for members to determine which option best suits their individual circumstances. Under the bill, the Board will evaluate and then adopt alternative option choices that enable the member to have nearly equivalent choices, without the current amount of confusion.

Postretirement Earnings Limitation

The current postretirement earnings limit is \$23,540 and is adjusted each July 1 to reflect increases in the CCPI. The earnings limitation was established in law on January 1, 2001 at \$22,000, using December 1999 as the base. This was equivalent to 50 percent of the average earnable salary of a CalSTRS member at that time. While the current limit reflects changes in the CCPI, increases in the CCPI have occurred at a slower rate than increases in the statewide average earnable salary of teachers. Active members' average earnable salary increased an average of 6.5 percent annually, between 1999 and 2001. Inflation has increased over the same period an average of 3.4 percent annually. As a result, the earnings limit is no longer tied to the average earnable salary of active members. Basing the earnings limit on the increase in the average earnable salary will re-establish that relationship and increase the earnings limit for fiscal year 2002-03 to \$24,933.

Acquire and Develop Surplus Land Owned by School Districts

SB 1983 allows CalSTRS to make investments related to the acquisition, planning, and development of surplus land owned by CalSTRS employers. It also requires that any such transaction satisfy the general fiduciary standards established in the TRL and Section 503 of the Internal Revenue Code that prohibits the system from acquiring any security, real property, or loan from an employer for more than adequate consideration.

This proposal conforms the restriction on investments in property owned by employers to those imposed on transactions concerning members, as well as standards imposed on CalPERS and corporate pensions under ERISA. Under the bill, Board members and other statutory fiduciaries for the System are required to exercise the same care, skill, prudence, and diligence for investments in employing agencies, as when investing in other securities, as outlined in existing law, the Investments Committee Charter, and the Investment Management Plan.

Under current law, prudent investment opportunities involving surplus land held by school districts and community college districts that could add value to the portfolio and the membership are lost. SB 1983 permits the System to participate in limited partnerships and joint ventures to acquire, develop, and sell these properties, or lease back to the districts themselves.

Customer Service Initiative

This bill includes a \$1.8 million appropriation from the Fund to provide enhanced customer services to active and retired members in the current fiscal year (2002-03). The need to increase expenditures for customer services is due to several factors, including:

- membership growth that is continuing at a rate of approximately two percent per year;
- an increasing number of members retiring, due to the increased age of CalSTRS members;
- recent benefit enhancements that have increased the demand for information and counseling;
- federal tax changes that have increased the need for member education and services;
- members expecting CalSTRS to provide a level of service that is on par with the service they would receive from private financial services providers.

In order to maintain and improve response time in phone calls to CalSTRS, increase counseling services, and improve response time to member inquiries through email and other correspondence, this bill provides funding for an additional 25 Personnel Years (PYs).

The additional resources will be allocated to the following CalSTRS program areas:

- **Phone Center:** The center's call volume (inquiries) has increased over the past three years, due to the implementation of various benefit enhancements, such as the longevity bonus and final year compensation, federal tax changes, and member demographics that show a steady increase in the percentage of members reaching retirement age. The number of incoming calls increased from 241,000 in 1999-2000 to 289,000 in 2001-02. The number of calls for 2002-03 is estimated to be 347,000. The current standard for answering calls is 95 percent of all calls within 3 minutes. An additional seven PYs will be allocated to the Phone Center to maintain and improve this service level to a response time of one minute, which is more consistent with private financial service entities.
- **Counseling Services:** The demand for counseling interviews and seminars is expected to increase from 32,000 in 2001-01 to 35,200 in 2002-03, due to many of the same reasons noted above and because, on a percentage basis, more CalSTRS active members are reaching retirement age. The increase in the demand for counseling services has created long delays in scheduling interviews. Currently, counseling interviews are conducted in-person. Other pension systems have successfully implemented telephone interviews in addition to in-person interviews. An additional eight PYs will be allocated to Counseling Services to decrease the wait time for an interview and test the efficiency of telephone-based counseling interviews.
- **Email/Correspondence:** The volume of email/correspondence will increase from 24,100 in 2001-02 to an estimated 36,200 in 2002-03. This is an increase of 500 percent over 3,500 emails/correspondence received in 2000-01. People who communicate by email expect a very rapid response to their inquiry. In order to accommodate this expectation, CalSTRS will establish a unit devoted expressly to responding to emails and written correspondence. An additional nine PYs will be allocated to meet the System's standard of responding to 95 percent of emails and correspondence within one business day and to address the increased workload.
- **Customer Satisfaction/Needs Assessment:** In order to determine member needs, satisfaction with services, and the importance of the current benefit structure, one PY will be allocated to establish and maintain an ongoing system to collect data regarding customer services.

FISCAL IMPACT

Benefit Program Costs

Modify Options 6 and 7 – The total costs of authorizing members to choose a new beneficiary after they “pop-up” to an unmodified allowance under Options 6 and 7 is expected to be minor.

Postretirement Earnings Limitation – Currently, retired members who exceed the earnings limitation have their allowances reduced dollar-for-dollar, based on the amount they exceed the limit. The amount of this ‘cost avoidance’ to the System is minor and is not factored into the System’s valuation of Fund. In the fiscal year ending June 30, 2002, the total amount of reductions to retired members allowances was less than \$50,000. This bill would reduce that reduction by an unknown, but probably insignificant, amount.

Administrative Costs – The bill includes an appropriation from the Fund of \$1.8 million to provide enhanced customer services to active and retired members in the current fiscal year (2002-03). Ongoing costs from the Fund would be reflected in future Budget Acts. If the Board changes the monthly allowance and annuity option, there would be one-time costs in 2005-06 to modify its complex system and permit members and participants to elect new options. All other costs of the bill are expected to be minor and absorbable.

BOARD POSITION

Sponsor. The Board is sponsoring this legislation, as it is consistent with the Board’s previous actions to enhance the services provided to CalSTRS members.